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CREDIT OPINION
15 September 2016

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RATINGS

Genesis Housing Association

Domicile	United Kingdom
Long Term Rating	Baa1
Type	LT Issuer Rating - Dom Curr
Outlook	Negative

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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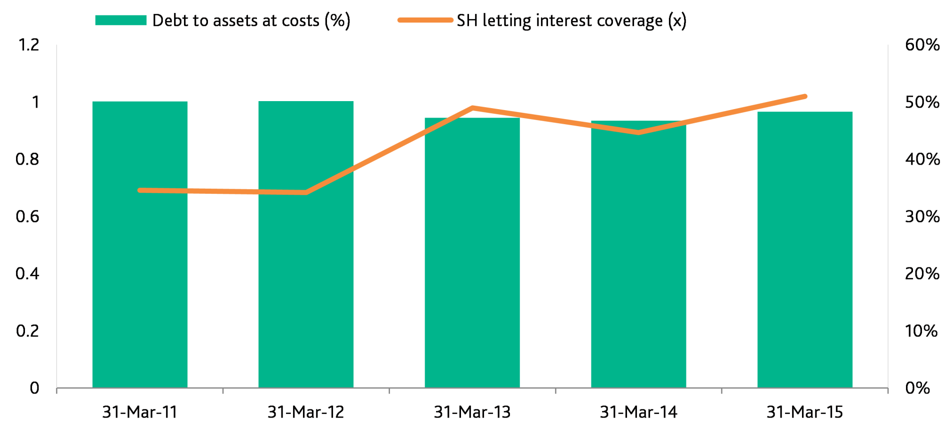
Genesis Housing Association

Update to Key Credit Factors

Summary Rating Rationale

On 29 June 2016, the issuer and debt ratings assigned to Genesis Housing Association (GEN) were downgraded to Baa1 from A2, following our credit assessment of the likely impact of their merger plan with Thames Valley Housing Association (TVHA). The merger was then called off on 23 August 2016, citing cultural and operational differences. However, we expect GEN to retain the heightened risk profile and anticipate a long term aggressive and commercially focused development programme leading to weaker interest cover ratios.

Exhibit 1
GEN's stable gearing and structurally low interest SH letting interest coverage
Gearing and SH letting interest cover, FY 2011-2015



Source: Moody's, GEN financial statements

The Baa1 issuer rating assigned to GEN reflects: (1) Large housing association operating in high demand areas; (2) strong balance sheet supported by historically low gearing. The rating also takes into account: (1) Growth uncertainty, following the termination of the merger with TVHA; and (2) GEN's anticipated to operate with low interest coverages.

In addition, ratings in the sector benefit from the strong regulatory framework governing English housing associations and our assessment that there is a strong likelihood that the UK government (Aa1 stable) would intervene in the event that GEN faces acute liquidity stress.

The entity is rated at the bottom of the Moody's-rated English housing associations, whose ratings span from Aa3 to Baa1. GEN's relative position reflects an expectation of increasing exposure to non-social housing activity, structurally low social housing interest cover and uncertainty with respect to future growth.

Credit Strengths

- Large housing association operating in high demand areas
- Strong balance sheet supported by low gearing
- Strong regulatory framework

Credit Challenges

- Management expected to focus on growth agenda following termination of proposed merger
- Government policy changes make operating environment more challenging for housing associations

Rating Outlook

The negative outlook on GEN's rating reflects the negative impact of the vote to leave the European Union on housing associations as well as the negative outlook on the sovereign rating, reflecting the close institutional, operational and financial linkages between the central government and housing associations.

Factors that Could Lead to an Upgrade

Moody's believes that upward ratings pressure on the HAs affected by the UK Sub-Sovereign Brexit action is unlikely to develop in view of the challenging operating environment and weakened sovereign credit conditions. However a combination of the following could have positive rating implications: (1) Despite the rent reduction a permanent reversal in their growth ambition and strengthening in social-housing-letting interest coverage structurally exceeding 1.2x; (2) a stable and coherent strategic vision

Factors that Could Lead to a Downgrade

Negative pressure could be exerted on the rating by one or a combination of following (1) oscillating business plans (2) reliance on sales and/or other high-risk activities to cover interest costs with social housing letting interest coverage ratio structurally below 0.8x; (3) New business plan and merger plans indicating an acceleration in GEN's aspirations. In addition, a weaker regulatory framework, a dilution of the overall level of support from the UK government or a downgrade of the UK sovereign rating would also exert downward pressure on the rating.

Key Indicators

Exhibit 2

Genesis Housing Association

	31-Mar-11	31-Mar-12	31-Mar-13	31-Mar-14	31-Mar-15
Units Under Management (no)	40,288	32,955	32,925	32,369	31,510
Operating margin, before interest (%)	8%	19%	20%	24%	25%
Net Capital expenditure as (%) turnover	10%	44%	16%	45%	60%
Reliance on low-risk activities: interest coverage (x times)	0.7	0.7	1.0	0.9	1.0
Cash interest coverage (x times)	0.4	1.5	1.8	1.0	0.6
Debt to revenues (x times)	4.9	5.6	4.8	5.3	5.4
Debt to assets at costs (%)	50%	50%	47%	47%	48%

Source: Moody's, GEN financial statements

Recent Developments

On 23 August 2016, GEN announced that its merger with Thames Valley Housing Association (TVHA) has been canceled citing “differences in style and approach”. The merger was expected to be completed in July 2016, following delayed consent from lenders. The core driver behind the merger was to create added capacity by forming a combined entity with 47,000 units under management and deliver an aspirational development pipeline of 3,000 units per year. GEN has stated their desire to move away from a grant subsidy model and towards a market subsidy model. While the merger might have failed, we believe that the organisation still remains committed in moving away from a grant subsidy model via increased long term market sale exposure.

On 23 June 2016, the UK voted to leave the European Union in a referendum and on 24 June 2016, a negative outlook was placed on the UK's Aa1 sovereign rating. We expect protracted trade negotiations, resulting in a high level of uncertainty in the medium term which will manifest in slower economic growth. On 29 June 2016, the outlook of GEN's Baa1 rating was changed to negative from stable reflecting that the vote to leave the EU is negative for housing associations (HA), whose creditworthiness is linked to the sovereign, driven by three main factors: 1) reduction in the predictability of policy-making as the sovereign could squeeze HAs budgets through additional cuts in housing benefit, grants, or other policy channels, 2) volatility in the housing market, which would impact, in particular, those HAs like GEN with expected greater exposure to open-market sales, and 3) the loss of EU funding for capital spending and potentially higher cost of borrowing when raising debt on the capital market.

Detailed Rating Considerations

GEN's Baa1 rating combines (1) a baseline credit assessment (BCA) of ba1 and (2) a strong likelihood of extraordinary support coming from the national government in the event that the entity faced acute liquidity stress.

Baseline Credit Assessment

LARGE HOUSING ASSOCIATION OPERATING IN HIGH DEMAND AREAS

GEN are a large social landlord with a housing stock under management that stands at 33,000. GEN operates across London and the South East England in approximately 86 local authorities, where demand for social housing is generally high and social housing rents are on average at 33% of market rates. This gap between social and market rent is credit positive as it supports high demand for social housing stock as well as revenue uplift should the organisation increase their exposure towards affordable housing and market rent. GEN was expected to become one of the ten largest social landlords post-merger.

STRONG BALANCE SHEET SUPPORTED BY LOW GEARING

GEN has a standalone gearing ratio of approximately 50%, this compares well to the 58% gearing of its ba1 peer (Poplar Harca). Similarly, debt to revenues remains modest, averaging 5.2x between FY2011-2015. We note that the organisation tightly reviews all covenants and we do not expect any future business plan to breach or come close to breaching their gearing covenant.

Despite reducing their annual grant funding over recent years, GEN will carry approximately GBP1.2 billion of historical grants on their balance sheet in FY2016. This high level of historical grant on balance sheet restricts their ability to deregister as a registered social housing provider despite. In an environment of low grant funding, GEN have consciously opted to limit their reliance on new grant funding, as such annual grants relative to turnover have dropped from 27% in 2011 to 3% in 2015. Although this downward trend is similar for orther organisations, GEN remains resolute to grow their business by filling the gap with debt and proceeds from their riskier and more volatile commercial activity.

STRONG REGULATORY FRAMEWORK

English housing associations operate in a highly regulated environment, with a strong oversight exercised by the sector's regulator, the Homes and Communities Agency (HCA). The regulator is responsible for protecting the public investment in social housing and compliance with broad economic and consumer standards. Compliance with the standards is proactively monitored by the HCA through quarterly returns, long term business plan and annual reviews, and focuses on: governance, financial viability, value for money and rents. The HCA's levers of control are wide ranging and include awarding capital grant funding, consent to dispose of or use assets to secure debt, levy financial penalties, and impose independent inquiries or appoint new managers and officers in extreme circumstances. The HCA emphasizes that their role is a co-regulatory one with the primary onus being on boards and executive teams to ensure compliance with the standards. We expect that the rapidly changing environment will put increased pressure on the regulator.

MANAGEMENT EXPECTED TO CONTINUE GROWTH AGENDA FOLLOWING TERMINATION OF MERGER

GEN's merger with Thames Valley was driven by the boards' desire to substantially increase their long-term development pipeline. While the merger might have been called off and while GEN will certainly not be subject to the same short term development risks, Moody's expects GEN to maintain a long term commercial development focus.

Moody's deemed GEN's merger aspirations as aggressive and noted that it would exert downward pressures on key rating metrics. The merged entity was to develop approximately 16,000 new units over the first 5 years, a sizeable increase from GEN's standalone 5 year plan (5,000 units). Despite the merger being called off, management are expected to maintain long term growth aspirations. Moody's anticipates that the organisation will continue to operate with low social housing letting and cash interest coverage ratios and we continue to expect market sales and commercial exposure to compose a large and growing portion of their turnover.

The merged business plan, illustrated that their apetitie for growth was high. Capital expenditure level was expected to remain high between FY2017-2019, averaging 110%, well above the 31% median of Moody's rated portfolio and far above GEN's standalone past five-year average of 35%. While we acknowledged that a majority of this development was uncommitted and GEN would only commit once funding is in place, we feel that these levels show their appetite for growth. Our view is that the termination of the merger will not change their long term growth aspirations, and this will ultimately result in lower cash and social housing interest covers.

This increased focus on non-social housing letting is a direct response to the 1% social housing rent reduction and the shift away from social housing will remain imminent in GEN zero subsidy growth model.

The focus of the executive team has centred on the merger for the last 12 months and consumed management resources. The last minute change of course will require the executive team to refocus their resources to and clearly define GEN's future.

GOVERNMENT POLICY CHANGES MAKE OPERATING ENVIRONMENT MORE CHALLENGING FOR HOUSING ASSOCIATIONS

The operating environment for social housing providers is fundamentally shaped by government policy and recent budget announcements have made these circumstances more challenging. On July 8th, 2015 the UK government announced (1) a change in the social housing rent formula to 1% annual reduction starting from April 2016 for four years (previously growth annually by CPI +1%) and (2) further reductions in the accessibility of certain welfare benefits. The effect of these measures is further magnified by the ongoing implementation of Universal Credit and the extension of Right to Buy for HA tenants. Overall, these policy shifts are gradually eroding the ties to the government, which we view as credit positive, by creating a more unpredictable operating environment and undermining the extent and stability of housing benefit's contribution to revenues.

The extension of the Right to Buy to housing association tenants may in short-term lead to positive cash inflows, but creates a risk of a longer term erosion of social housing stock if this stock is not replaced on a 1:1 ratio. We will continue to monitor the impact of the proposed Right to Buy extension on GEN's asset base and revenues.

Extraordinary Support Considerations

The strong level of extraordinary support factored into the rating reflects the wide ranging powers of redress available to the regulator in cases of financial distress, with the possibility of a facilitated merger or a transfer of engagements. Recent history has shown that the UK Government (Aa1 negative) is willing to support the sector, as housing remains a politically and economically sensitive issue. The strong support also factors housing associations' increasing exposure to non-core social housing activities that add complexity to their operations and make an extraordinary intervention more challenging.

In addition, our assessment that there is very high default dependence between GEN and the UK government reflects their strong financial and operational linkages.

Rating Methodology and Scorecard Factors

European Social Housing Providers, July 2016 (190944)

Government-Related Issuers, October 2014 (173845)

Ratings

Exhibit 3

Category	Moody's Rating
GENESIS HOUSING ASSOCIATION	
Outlook	Negative
Issuer Rating -Dom Curr	Baa1
GENFINANCE II PLC	
Outlook	Negative
Senior Secured -Dom Curr	Baa1

Source: Moody's Investors Service

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